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SUBJECT: INFRASTRUCTURE FORUM ATTRACTS INVESTORS AND
HIGHLIGHTS MODEL PROJECTS

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¶11. (SBU) Summary. The Government of Indonesia (GOI) renewed its appeal for private investment under its five-year, USD 150 billion infrastructure development program at a November 1-3 Infrastructure Forum in Jakarta. President Susilo Bambang Yudhoyono (SBY) touted improvements in Indonesia's investment climate, but also acknowledged investor concerns over the need for a transparent and fair regulatory framework. Minister of Finance Sri Mulyani assured investors that the National Committee for the Acceleration of Infrastructure Provision (KKPPI) would evaluate all Public-Private Partnership (PPP) projects in the infrastructure sector according to established, transparent criteria. Coordinating Minister for the Economy Boediono announced separate risk guarantee, infrastructure investment, and revolving land acquisition funds to which the GOI plans initial contributions of Rp 4.7 trillion (USD 503 million). Unlike the 2005 Infrastructure Summit (Ref C), the GOI narrowed its focus to ten model projects across five sectors worth USD 4.4 billion, although none are yet ready for tender. Ministers from infrastructure-related ministries were on hand to meet one-on-one with potential investors in five separate break-out sessions. Energy sector projects attracted the most interest. The World Bank and the Asian Development Bank (ADB) announced at the conference that they are expanding their support for the KKPPI with program and project loans as well as possible contributions to the proposed risk guarantee fund. A senior official from the Japanese Bank of International Cooperation (JBIC) unveiled an "umbrella agreement" his organization has signed with the Ministry of Finance (MOF) that acts as an indirect GOI guarantee for power projects. China and Japan continued their thinly-veiled competition over Indonesian infrastructure projects at the Forum, particularly in the power sector. This report uses an exchange rate of Rp 9130/USD for all transactions. End Summary.

¶12. (U) Nearly two years after the January 2005 Infrastructure Summit, The Indonesian Chamber of Commerce (KADIN) and the Coordinating Ministry for Economic Affairs co-sponsored a follow-up "Infrastructure Forum" from November 1-3 in Jakarta. Over 1000 delegates from 300 Indonesian companies and 100 foreign firms attended the Forum. The Forum agenda underscored the GOI's more focused

efforts under President Susilo Bambang Yudhoyono (SBY) to attract greater private investment into its USD 150 billion, 5-year infrastructure plan.

SBY Cites Positive Climate, Acknowledges Challenges

13. (U) In his opening address, SBY touted improvements in Indonesia's investment climate and macroeconomic situation, including a successful transition to democracy, increased political stability, strengthened anti-corruption efforts, rising GDP growth, and a rising per capita income of USD 1500 that now exceeds pre-crisis levels. He cited the stable Rupiah, Jakarta's strong stock market, and reserves of over USD 40 billion as concrete signs of Indonesia's underlying economic health.

14. (U) The President candidly acknowledged significant economic challenges facing Indonesia and said that infrastructure development stands at the top of the list. During the years following the financial crisis the GOI virtually stopped funding infrastructure, a trend Yudhoyono said the country must reverse. (Note: Pre-crisis infrastructure spending stood at about 6% of GDP, almost three times the level in 2005). He appealed to private investors to participate as partners in the USD 22 billion annual investments needed for the energy sector, roads, ports, harbors, housing, water, and sanitation.

15. (SBU) SBY also addressed on-going investor concerns over substandard project feasibility studies, lack of transparency in the bidding process, and regulatory uncertainties. He stressed that Presidential Regulation

JAKARTA 00013236 002 OF 007

67/2005 provides a more robust legal and regulatory framework for PPPs in infrastructure development, and said the KKPPI would ensure all projects meet international standards of transparency and fairness in the tender and bidding process "from start to finish." Minister of Finance Sri Mulyani echoed the President's remarks, saying that the KKPPI is already working with sixteen line ministries and is evaluating the quality of all proposed PPP projects according to the standards of Presidential Regulation 67/2005. (Comment: "PPP Nodes", one of the key components of the KKPPI process, are not yet up and running in all infrastructure-related line ministries. End Comment.)

Funds for Guarantees, Projects, Land Acquisition

16. (SBU) Ministers Boediono and Mulyani provided detail on three, separate infrastructure-related funds the GOI has set up or proposed:

-- The GOI has established a "Risk Guarantee Fund" with an initial, Rp 2.5 trillion (USD 274 million) contribution from the 2006 and 2007 national budgets. In addition, the GOI has asked the World Bank, ADB and other institutions to support the Risk Guarantee Fund through partial credit guarantee or other risk management products. In response to questions about whether investors in non-KKPPI projects would be able to take advantage of the Risk Guarantee Fund, the GOI has stated clearly in the Letter of Development Policy for its forthcoming, USD 400 million ADB "Infrastructure Reform Sector Development Program" loan that it only projects that fully comply with the KKPPI would be eligible for support through the Risk Guarantee Fund.

--Mulyani announced the GOI would establish an "Infrastructure Investment Fund" with an initial contribution of Rp 1.5 trillion (USD 164 million, also from the 2006 and 2007 budgets. This fund is intended to fund direct GOI participation in infrastructure projects, likely through Indonesian state-owned enterprises (SOEs).

--Boediono stated the GOI would ask Parliament for funds to establish a Rp 600 billion (USD 66 million) revolving land acquisition fund. The Ministry of Public Works will manage the fund, under guidelines the National Land Agency (BPN) will draft. According to Boediono, the guidelines will ensure land acquisition is both "investor-friendly" and "not at the expense of vulnerable groups."

17. (U) Once established, the land acquisition fund could play an important role in breaking the current deadlock over land acquisition for toll road and other infrastructure projects. Presidential Regulation 65/2006 and other regulations limit the legal options available to property owners to challenge Government efforts to acquire land for infrastructure projects, an important consideration for land-intensive toll road development. However, the GOI has been extremely reluctant to acquire land through eminent domain-type legal proceedings, and most current toll road projects have stalled as a result. Observers believe few, if any, foreign investors will enter the toll road market in Indonesia without very strong assurances from the GOI on land acquisition. Potential investors have long sought such a revolving fund to finance land acquisition to limit or remove this risk for investors.

Clarification on Risk Sharing for Existing Projects

18. (U) Finance Minister Sri Mulyani provided some clarification on the complex issue of the availability of government guarantees or support for various types of PPP projects, a threshold issue for most investors. Under Finance Ministry Decree 38/2006 issued in May 2006, the government may consider sharing political, project performance, and demand risk. Mulyani stated that a Risk Management Unit (RMU) within the MOF would review all requests for government guarantees for projects awarded

JAKARTA 00013236 003 OF 007

under Presidential Regulation 67/2005 based on the risk-sharing principles in MOF Decree 38/2006. As in prior infrastructure meetings, Mulyani cautioned investors not to expect blanket guarantees. However, she pledged that the GOI would evaluate guarantee proposals for high quality projects based on "a reasonable rate of return." She added that the GOI needs to issue another Presidential Regulation to address guarantees for regional projects.

19. (SBU) The GOI also clarified how it would approach requests for GOI financial or risk sharing support for projects that fall outside Presidential Regulation 67/2005 and MOF Decree 38/2006. Some of these projects were awarded during the Suharto era, but have been stalled since the 1997-98 financial crisis. In Mulyani's remarks and its October 24 ADB Letter of Development Policy, the GOI has outlined how it will treat infrastructure projects that fall outside the KKPPI system:

--Projects to be Directly Executed by the Government or Contracting Agencies: The GOI plans to design and execute infrastructure projects using purely public sector resources. The most noteworthy example of this type of project is the 10,000 megawatt "crash program" for electricity generation in which a number of Chinese companies and banks have expressed keen interest.

--Projects Awarded Prior to Presidential Decree 67/2005 and MOF Decree 38/2006: The MOF will review these pre-KKPPI projects already in the pipeline on a case-by-case basis, and if they do not meet the requirements of the two decrees, will "apply the principles of transparency, accountability, proper risk allocation and sharing, and fiscal prudence in determining fiscal support for such projects through the general budget allocation process." (Comment: In conjunction with the pledge to use Risk Guarantee funds only for projects fully in compliance with the two regulations,

this commitment appears to require investors in the large number of stalled infrastructure projects tendered or awarded by previous administrations to work through the Parliamentary budget process to obtain GOI support, likely a difficult endeavor. End Comment.)

¶110. (SBU) In a statement likely directed toward developers of Jakarta's USD 650 million monorail project, Mulyani said that "if projects are tendered without a guarantee, they should not come back later" seeking one. Her comments reflect a continuing dispute inside the GOI on whether to offer a GOI guarantee to the Dubai Islamic Bank which is financing the monorail. (Comment: The GOI may have resolved this dispute. An infrastructure expert at the Forum told us the MOF recently signed a "comfort letter" offering a modest ridership guarantee capped at USD 25 million annually to the stalled project. The GOI has kept this comfort letter out of the media. End comment.)

Model Projects Span Sectors

¶111. (U) Unlike the 2005 Infrastructure Summit, this year the GOI focused its pitch to investors on a short-list of ten model projects worth USD 4.4 billion. Coordinating Minister for Economic Affairs Boediono acknowledged the poor response of investors to the 91 projects announced at the 2005 Summit because "the projects were not properly and adequately prepared". In contrast, the GOI considers the Forum's ten model projects, crossing the energy, transportation, public works, and telecommunications sectors, commercially viable and "bankable," Boediono said. Each of the projects will go through the KKPPI and RMU review processes from start to finish. Although the GOI provided information memoranda on several of the projects, no tender documents were ready at the Forum. Participants noted that several of the model projects are still in the feasibility assessment stage, and encouraged the GOI to focus on moving an initial one or two model projects through the KKPPI and RMU review process to demonstrate to investors that the two institutions are fully functioning.

JAKARTA 00013236 004 OF 007

Table 1: Infrastructure Forum: 10 Model Projects

Project	Estimated Value(1)
Telecommunications:	
Palapa Ring fiber optic network	1,500
Power plants:	
2x600 MW coal-fired plant (Central Java)	1,200
500 MW coal-oil fired plant (East Java)	275
Toll roads:	
165 km Solo-Kertosono (Central Java)	928
60 km Medan airport road (North Sumatra)	142
Sea ports:	
Surabaya Tanjung Perak expansion	280
Margagiri-Ketapang ferry terminal (Java to Sumatra)	97
Water and sanitation projects:	
Dumai (Riau Province)	44
Tangerang, Banten (greater Jakarta)	37
Bandung (Java)	26

(1) In USD millions.

Note: Information memoranda are available on the KKPPI website (<http://www.kkpri.go.id>) for all projects except the Surabaya Tanjung Perak expansion.

Ministers Pitch Projects in Break-Out Sessions

¶12. (U) Forum organizers delivered on their pledge of offering full access to key infrastructure ministers. Highlights from individual breakout sessions follow:

--Transportation: Minister of Transportation M. Hatta Rajasa promised investors that the Transportation Law amendments for air, land, sea, and rail, expected to pass Parliament by early 2007, would "revoke the state-owned enterprise monopoly" on transportation, permit longer concession periods, and allow foreign investors "free rein" to build and operate transportation infrastructure. Investors representing existing port facility operators in Surabaya pressed Rajasa on the need for the Lamong Bay container port project in Surabaya, given the significant underutilization of current facilities. Rajasa responded that Lamong Bay is a "long-term" project and planning for anticipated growth in 2010 and beyond.

--Water Resources: Public Works Minister Djoko Kirmanto highlighted the three model municipal water supply and sanitation projects, noting that only 17% of all Indonesians have piped water into their homes, and only 8% in rural areas. The model projects offer 25 year concession agreements to inject greater efficiency into the existing system where 63% of municipal water companies are essentially bankrupt. The proposed water project in the Jakarta suburb of Tangerang would serve the most rapidly growing area in greater Jakarta with a current population of 243,000. Many consumers currently purchase potable water trucked into urban areas at much higher cost.

--Telecommunications: Communications Minister Sofyan Djalil unveiled an ambitious agenda to transform Indonesia into a fully connected information society by 2015. Indonesia has one of the lowest rates of mobile and fixed line penetration in South East-Asia according to Arwin Rasyid, director of state-owned telecommunications company PT Telekom. Rasyid added this low level of penetration represents a tremendous (and lucrative) capacity for growth. Telecom Minister Djalil presented GOI plans for an ambitious "Palapa Ring" project that would create a self-contained fiber optic ring

JAKARTA 00013236 005 OF 007

running through seven major Indonesian islands at a cost of USD 1.5 billion. The Telecommunication Ministry estimates a 21% internal rate of return on the projects and a five-year revenue stream of USD 2.9 billion. However, some investors voiced doubts about the project's feasibility and questioned the need for a new, privately funded fiber optic ring when Telekom could use its existing networks and keep the project for itself. Investors also commented on the fact that interconnection rates in Indonesia are among the highest in the world and a major cost barrier for new entrants in the market. Minister Djalil assured investors that the GOI is formulating regulations to reform lease line regulations. Investors tell us that unclear regulatory authority and GOI support for the Telekom/Indosat duopoly are major barriers to potential investment.

--Toll Roads: Minister Djoko Kirmanto told investors that from 2005-2009, Indonesia hopes to build 1,100 kilometers, of toll roads at a cost of Rp 80 trillion (USD 8.7 billion). More than 760 kilometers would be included in the "Trans Java" system, the GOI's top toll road priority. According to Kirmanto, Presidential Regulation 65/2006 has streamlined the process of clearing land titles and increased the certainty of land acquisition. The proposed revolving land acquisition fund should also give the GOI greater flexibility to acquire land before tendering projects. However, land titling and acquisition remain the greatest concerns for investors.

Interest level Highest on Energy Projects

¶13. (U) Interest among potential investors remains highest in Energy Sector projects, particularly in the electric power generation sub-sector. The GOI offered two model projects in this sub-sector:

--Central Java Coal-Fired Power Plant: A 1,200 MW coal-fired thermal plant developed on a build-own-operate basis at an estimated cost of USD 1.2 billion

--Pasuruan Combined Cycle Power Plant, East Java: A 500 MW double chambered coal-fired plant developed on a build-own-operate basis at an estimated cost of USD 275 million.

¶14. (U) Minister of Energy and Mineral Resources Purnomo Yusgiantoro said the GOI would strictly follow the KKPPI process for the two model electricity projects. The GOI has completed site studies and bidding documents for both projects, but potential investors must complete feasibility, environmental, and energy sourcing studies, according to Purnomo. Although Purnomo set a goal of getting the projects into KKPPI process by 2007, he was unable to give an exact timeline, noting much of the institutional structure of the KKPPI process is not yet fully functional.

¶15. (SBU) Investors also focused their interest and questions on projects announced earlier in the year under the so-called 10,000 MW "crash program." The program aims to add 10,000 MW to the national grid by 2009. To date, the GOI has identified 40 fast-track projects totaling more than 8,750 MW. The largest project will be on the island of Java with planned operational dates of 2010. Purnomo said these projects must be transparent. He also said GOI funding for these projects should not take precedence over those following the full KKPPI process. The two model electricity projects are former "crash" projects previously offered through direct bid. Purnomo offered no explanation as to why the GOI had reclassified them as model projects.

(Comment: A source at the ADB told us the bank had required the GOI to include two of the larger crash program power projects on the KKPPI as a condition for granting its \$400 million Infrastructure Reform Sector Development Program loan. End Comment.)

Clarification on Public Service Obligations

JAKARTA 00013236 006 OF 007

¶16. (U) State electricity company PLN will be the first beneficiary of the 2003 GOI Public Service Obligation (PSO) compensation policy. In the past, the GOI required State Owned Enterprises (SOE) to subsidize unprofitable basic services provided to the public through "hidden input subsidies," according to Finance Minister Sri Mulyani. This opaque process hindered accountability as well as performance benchmarking of SOEs. The GOI will now directly compensate the SOEs for the full cost of their PSOs. PLN will receive direct compensation based on the difference between prevailing tariffs and the cost of supply. PLN may also seek reimbursement for costs such as electricity purchases and debt service. The GOI included a Rp 35.5 trillion (USD 3.8 billion) line item in the revised 2006 budget to cover PLN's public service obligation.

¶17. (U) The PSO policy also forms the basis for an indirect GOI guarantee for energy sector projects through an "umbrella agreement" between the Japanese Bank of International Cooperation (JBIC) and the GOI. The agreement will allow JBIC financing of power projects without a GOI "comfort letter" or other blanket guarantee. According to a model project prospectus provided by the GOI, PSO subsidy funds may be used to meet any payment defaults by PLN. The agreement apparently reiterates the GOI commitment to honor

PSOs as provided for under Indonesian law. The GOI has also stated its intent to use a similar, PSO-linked guarantee mechanism for power projects not funded by JBIC as well as projects in other sectors.

¶18. (U) Investors in the forum expressed their frustration at the lack of deregulation in the electricity and mineral resources sectors. Purnomo noted the GOI and Parliament are reviewing key energy deregulation laws, but decisions are not expected until 2007. The key stumbling block to energy sector deregulation is the Indonesian Constitution which requires state ownership of sensitive industries. The Supreme Court struck down the 2002 electricity law as unconstitutional for this reason, and Purnomo offered no thoughts on how the GOI would craft a new law that meets the constitutional strictures while creating meaningful incentives for private investment.

Development Banks Support, Japan and China Compete

¶19. (U) Development lenders including the World Bank, the ADB, and JBIC signaled their strong commitment to support the GOI through program and project loans as well as financial support for the risk guarantee fund. The ADB has completed negotiations on its USD 400 million infrastructure reform program loan and an associated USD 19 million project loan to support the establishment of an infrastructure "Project Development Facility." The ADB and World Bank have signaled their willingness to contribute to the GOI's Risk Guarantee Fund. Additionally, the World Bank has provided a USD 425,000 grant to build capacity at the RMU.

¶20. (SBU) The Forum also highlighted continuing competition between Japan and China for Indonesian infrastructure projects, particularly in the power sector. During SBY's late October trip to China, Energy and Mineral Resources Minister Purnomo signed agreements with Chinese companies for six coal-fired power projects worth USD 4.26 billion. Chinese companies have become major oil producers in Indonesia and are prominent on the list of firms competing for contracts under the 10,000 MW crash electricity building program. Each of the Chinese bidders is allied with one or more Chinese banks offering export credits to finance the projects. For its part, the Japanese government has aggressively used JBIC financing to win tenders, and JBIC financed the two large power plants in Java that came online in 2006. Japan's Marubeni consortium recently won the rights for a 600 MW power plant in Cirebon.

¶21. (SBU) If China has dominated in the electricity "crash program," Japan was the clear winner in the Infrastructure Forum. Unlike the Infrastructure Summit of 2005 where 38

JAKARTA 00013236 007 OF 007

Chinese firms participated, the 2006 conference saw only four Chinese firms register. In contrast the forum featured a prominent role for Japanese presenters, including Fumio Hoshi, executive director of JBIC, and large numbers of attendees from Japanese companies.

¶22. (SBU) Comment. The Forum achieved one of its main goals -- reigniting interest in the GOI's infrastructure plan. Organizers presented a forum with significant access to top-level officials, and attracted broad participation by potential investors, suppliers, and service providers. Ministers Boediono and Mulyani were also convincing in their pledge to continue institutionalizing the KKPPI review process to gain the long-term confidence of private and international investors. However, the Forum provided no major new announcements, and the paramount challenge over the next 6-9 months will be to begin moving projects to tender through the KKPPI process. For all the GOI's good work, many investors remain skeptical, and overwhelmingly say they need to see at least one model project completed to convince them that infrastructure development in Indonesia

will be transparent, fair, and competitive.
End comment.

PASCOE